Cite as Det. No. 18-0017, 37 WTD 237 (2018)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of Assessment of	)	D E T E R M I N A T I O N
	)	No. 18-0017
. . .	)	Registration No. . . .

RULE 170; RCW 82.04.050, RCW 82.08.020: RETAIL SALES TAX – B&O TAX – JOINT VENTURE – SPECULATIVE BUILDER – PRIME CONTRACTOR – RESIDENTIAL CONSTRUCTION – OWNERSHIP OF LAND. Because neither Taxpayer nor the joint ventures were the bona fide owners of the properties, we conclude that Taxpayer was the prime contractor and is liable for retail sales tax and retailing B&O tax.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

Margolis, T.R.O. – A Washington construction company (Taxpayer) protests the assessment of retailing business and occupation (B&O) tax and retail sales tax on grounds that the Department of Revenue Audit Division (Audit) erroneously classified Taxpayer as a prime contractor rather than a speculative builder. Taxpayer also contends that, if it is a prime contractor, it is eligible for tax paid at source deductions. We deny the petition in part and grant the petition in part.[1]

ISSUE

Whether, under WAC 458-20-170 (Rule 170), Taxpayer is a prime contractor and liable for retail sales tax and retailing B&O tax on receipts for constructing houses on property owned by third parties.

FINDINGS OF FACT

Taxpayer is a residential construction company in . . . Washington. The Department of Revenue's Audit Division (Audit) examined Taxpayer's records for the period of January 1, 2012, through September 30, 2015, and on November 15, 2016, assessed Taxpayer $ . . . . The assessment [includes] $ . . . in retail sales tax, $ . . . in retailing [B&O] tax, $ . . . in interest, and $ . . . in 5 percent assessment penalty.

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

Audit reclassified what Taxpayer had deemed speculative builder income to amounts subject to retailing B&O tax and retail sales tax as a prime contractor. This reclassification was in connection with receipts from [LLC 1] and [LLC 2], which Audit determined were retail sales of construction services.

On December 21, 2012, [LLC 1] acquired a portion of vacant land located at . . . Washington, from [Land Owner]. The property was short platted. Lot 1 was retained by [Land Owner] and [LLC 1] purchased Lot 2. On February 22, 2013, Taxpayer and [LLC 1] entered into a joint venture agreement, which provides that [LLC 1] is the capital investor, Taxpayer is the managing investor whose duties include locating the property and arranging for any improvements that it deems necessary, and profits will be split between the parties. [LLC 1] did not transfer ownership of the property to the joint venture. Exhibit A of the agreement is a cost/profit summary, which shows a cost of work of $ . . . for "Lot 1: . . . New Residence," which is the "Considered 'Purchase Price' of Lot 2."

[The joint venture] constructed a house for [Land Owner] on Lot 1, and constructed another house on Lot 2, which [LLC 1] sold for $ . . . .[2] Construction on both lots started during 2013.

The joint venture agreement dictates distribution of income as follows:

> 7. **DISTRIBUTION OF INCOME**. It is understood that [Taxpayer] does not owe [LLC 1] money, but rather the individual property owes the money, and thus reimbursement of any advances or expenses will come upon the processing of said income received by the sale of the property, and not before. Following the receipt of said income, income will be distributed in the following order: See Exhibit A – Monthly Expenses
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> a. First Distribution will be to [Taxpayer] for reimbursement to the extent of all out-of-pocket costs, expenses and/or advances (including property specific and pro-rata as detailed above) for that property.
> b. Second Distribution will be to [LLC 1] for reimbursement to the extent of all out-of-pocket costs, expenses and/or advances (including property specific and pro-rata as detailed above) for that property.
> c. Third Distribution will be to [Taxpayer's] share and [LLC 1] share in a percentage split of profits from the project of 50/50. See exhibit A
>
> Said Distributions of Income will be paid upon closing to the account as designated by the party receiving said distribution.

Joint Venture Agreement between [LLC 1] and Taxpayer, Page 3.

Between February 2012 and February 2013, Taxpayer received funds from [LLC 1] totaling $ . . . that were related to Lots 1 and 2. For example, on March 15, 2012, Taxpayer received $ . . . described as "MARCH Draw – . . . ," on April 11, 2012, Taxpayer received $ . . . , and on February

[2] The . . . Department of Assessments shows that, on December 24, 2013, [Land Owner] executed a Statutory Warranty Deed conveying Lot 2 to [LLC 1] for $ . . . , and on May 5, 2014, [LLC 1] sold Lot 2 to a third party for $ . . ..

19, 2013, Taxpayer received $ . . . described as ". . . – architectural fees." All of these receipts are dated prior to the joint venture agreement.

On March 2, 2014, Taxpayer and [LLC 2] entered into a joint venture agreement for purchasing, developing, and re-selling a single family residence at . . . Washington. [LLC 2] agreed to purchase the property with an anticipated closing date of March 27, 2014, contribute a $ . . . down payment, and sign a promissory note in the amount of $ . . . , payable to the sellers secured by a second lien deed of trust. Taxpayer entered into a construction contract with [LLC 2] providing for the renovation and construction of a house on the property, "the bid amount being $ . . . including Washington State sales tax." Joint Venture Agreement between [LLC 2] and Taxpayer, Page 1. Taxpayer was to handle the entire project, including locating and acquiring the property and handling the eventual sale. The agreement states that [LLC 2] owns the property for the benefit of the joint venture and acknowledges the possibility of loss. Section 6 explains the distribution of income as follows:

> 6. **Distribution of Income**. The income from the Joint Venture shall be disbursed in the following order:
>
> 1. First, to all vendors of the Joint Venture, including the obligations created under the [Seller's] Note and Deed of Trust;
> 2. Second, to [Taxpayer] to the extent of all documented out of pocket costs, amounts owing under the Construction Contract, and other expenses or advances incurred on behalf of the Joint Venture;
> 3. Third, to [LLC 2] to the extent of all documented out of pocket expenses incurred by [LLC 2], including but not limited to all sums advanced to purchase the Property, all sums expended to pay taxes, insurance and debts secured by the Property, all sums expended under the Construction Contract and all other sums advanced to [Taxpayer] under this Agreement, including Additional Expenses;
> 4. Fourth, all remaining sums shall be disbursed equally between [LLC 2] and [Taxpayer]. . . .
>
> In the event there is any loss in the operation of the Joint Venture, it shall be borne exclusively by [LLC 2].

Taxpayer explained to Audit that the bid amount of $ . . . was increased to improve the selling price of the home. [LLC 2] paid Taxpayer $ . . . . Taxpayer asserts that it was required to repay $ . . . to the [LLC 2] joint venture due to the fact that the venture did not prove to be as profitable as first estimated. Taxpayer provided a QuickBooks screen print evidencing a check paid to the order of [LLC 2], which includes the notation " . . . Repayment for going over the speculated amount of the job."

Taxpayer petitioned for correction of the assessment, asserting that the above jobs were done as a speculative builder. Taxpayer also provided invoices seeking additional credit for tax paid at source. The invoices are billed to Taxpayer rather than any joint venture. Audit responded to Taxpayer's petition and, in its discussion regarding [LLC 1], wrote that "[i]f this project is upheld

as a custom construction project, credit is due on the invoices shown on Exhibit A." Letter from Audit dated February 9, 2017, Page 3.

ANALYSIS

RCW 82.04.220 imposes B&O tax on every person for the act or privilege of engaging in business activities in Washington. The tax is measured by applying particular rates against the value of products, gross proceeds of sale, or gross income of the business as the case may be. *Id*.

RCW 82.08.020 imposes retail sales tax on each retail sale in Washington. Generally, the seller must collect sales tax from the buyer, and then remit the collected tax to the Department. RCW 82.08.050. The term "retail sale" includes the sale of or charge made for tangible personal property consumed and/or for labor and services rendered in respect to the constructing, repairing, decorating, or improving of new or existing buildings on real property of or for consumers. RCW 82.04.050(2)(b). If the seller fails to collect the tax, the seller must still pay the tax to the Department. RCW 82.08.050(3).

Rule 170 is the Department's administrative rule implementing the statutes regarding construction activities, RCW 82.04.040, RCW 82.04.050, RCW 82.08.020, RCW 82.08.130, and RCW 82.12.020. Prime contractors are taxable upon the gross contract price under the retailing B&O tax classification. RCW 82.04.050(2)(b); Rule 170(3)(a). Prime contractors are also required to collect from consumers the retail sales tax measured by the full or gross contract price. *See* RCW 82.08.020. Speculative builders, in contrast, construct buildings for sale or rental upon real estate they own.[3] Rule 170(2). Where a person performs construction upon land owned by their co-venturers, they are constructing upon land owned by others and are taxable as sellers rather than speculative builders. *Id.*

In this matter, Taxpayer asserts that it had formed joint ventures that were the equitable owners of the properties, the joint ventures should be treated as speculative builders, and Taxpayer is not a prime contractor subject to retailing B&O tax and retail sales tax on amounts received in connection with these projects.

. . .

. . . [I]n order to be a speculative builder, the person performing the construction must own the real property upon which the construction is performed. Rule 170(2)(a); *Dep't of Revenue v. Nord Northwest Corp.*, 164 Wn. App. 215, 264 P.3d 259 (2011) (*Nord).* The *Nord* case involved a dispute over the assessment of retail sales tax and retailing B&O tax on the construction and sales of two condominiums located on land owned by two limited liability companies . . . . The construction of the condominiums was performed by an incorporated, licensed construction contractor (Nord) whose sole shareholder also had an ownership interest in the limited liability companies.[4] Pertinent sections of the Appeals Court's *Nord* decision read as follows:

[3] Speculative builders pay sales tax or use tax upon all materials purchased by them, and on all charges made by their subcontractors, but do not pay B&O tax on the sale or lease of the building they have constructed. Rule 170(2).
[4] Nord had only one shareholder.

> Neither the language nor the purpose of [Rule 170(2)] creates an exception to the requirement that the builder must be the bona fide owner of the real property to qualify as a speculative builder. . . .
>
> In this case, Nord was a member of two LLCs and perform[ed] construction services on real property owned by those LLCs. [Nord] "performed construction on land owned by …. [its] co-venturers, etc." and was therefore "constructing upon land owned by others and is taxable as a seller under this rule, not as [a] "speculative builder."

164 Wn. App. at 233.

In Det. No. 13-0227, 35 WTD 366 (2016), we held that a taxpayer did not qualify as a speculative builder when the taxpayer, in a joint venture with an LLC, constructed three single family homes on land purchased and owned by the LLC. The taxpayer in that matter entered into joint venture agreements with the LLC, the LLC purchased the properties and borrowed the funds for development, and the LLC was listed on the escrow documents as the sole seller. The joint venture agreement provided that the LLC would contribute the land, and the taxpayer would contribute the construction. We concluded that the taxpayer provided construction services on land owned by its co-venturer and was taxable as a seller, explaining as follows:

> All three land parcels in this case were owned by the LLC. At the time of land purchase, the listed purchaser of the properties was the LLC. The financing for the improvements to the land was secured and guaranteed by the LLC, and, after construction, the three improved parcels were sold by the LLC. [In conclusion, amounts received by Taxpayer for performing construction services on land owned by the LLC were properly characterized as payments to a prime contractor and subject to retail sales tax and retailing B&O tax.]

35 WTD 371.

In this matter, it is undisputed that [LLC 1] and [LLC 2] purchased the properties, and title in the properties was not transferred to the joint ventures. [Nor did the joint venture perform the construction services in the LLC 2 project.] Taxpayer argues that 35 WTD 366 does not apply because the joint ventures in this matter had equitable ownership of the properties. We disagree, and find no grounds for concluding that the joint ventures were the owners for purposes of Rule 170(2) where the properties were purchased by alleged joint venture partners and neither the builder nor the joint ventures were the *bona fide* owners. [In addition, even if the land were owned by the joint venture, the joint venture in the LLC 2 project did not perform the actual construction; Taxpayer did under the terms of its construction contract with LLC 2.] Taxpayer has the burden of showing that the co-venturer transferred the property to the joint venture. 35 WTD 370, FN 10. Taxpayer has not met this burden by including language in the joint venture agreements indicating that the property purchases were contributions, and we find no grounds for concluding that ownership of the properties in this matter is materially different from the ownership of the properties in 35 WTD 366. Because neither Taxpayer nor the joint ventures were the bona fide

owners of the properties, we conclude that Taxpayer was the prime contractor and is liable for retail sales tax and retailing B&O tax.[5]

Since we find that Taxpayer was the prime contractor on these projects, we remand the assessment to Audit to make adjustments to the extent the records Taxpayer provided demonstrate that it qualifies for additional tax paid at source deductions.[6]

DECISION AND DISPOSITION

We deny Taxpayer's petition in part and grant it in part. We deny Taxpayer's petition with respect to its claim that it was a speculative builder. We grant the petition with respect to additional deductions for tax paid at source to the extent Taxpayer has provided adequate records to substantiate further deductions, and remand the case to Audit to make such adjustments.

Dated this 19th day of January 2018.

[5] [Had the joint venture in either project been the bona fide owner of the land, we would need to determine whether the joint venture also performed the actual construction. In the LLC 2 project, the evidence establishes that Taxpayer, not the joint venture, performed the actual construction. For this additional reason, we conclude that the LLC 2 project does not qualify as speculative construction.]

[6] Taxpayer also asserts that it was assessed retail sales tax on invoices where the Department had collected the tax from its vendors. Absent evidence that the Department collected retail sales tax twice on the same sale, we find no grounds to provide relief.